

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

In re Case Nos. 02-55527-JRG and  
02-55528-JRG  
SAN JOSE MEDICAL MANAGEMENT,  
INC., a California Corporation,  
and affiliated Chapter 11 cases,  
Chapter 11  
Debtors.

ORDER ON CROSS SUMMARY JUDGMENT MOTIONS  
REGARDING THE OBJECTION TO THE CLAIM OF PACIFICARE

I. INTRODUCTION

On December 13, 2005, the court heard the cross summary judgment motions of Uecker & Associates, Inc., as trustee of the San Jose Medical Group Trust for the Benefit of Creditors ("Trustee") and PacifiCare of California ("PacifiCare") regarding Trustee's objection to PacifiCare's claim. In particular, the parties cross moved for a determination of whether: (1) the loan agreement between debtor San Jose Medical Group ("SJMC") and PacifiCare is an executory contract governed by Bankruptcy Code § 365; and (2) Bankruptcy Code § 1124 applies to this claim. For the reasons discussed below, the court finds that the loan agreement is not an executory contract and

1 Bankruptcy Code § 1124 does not apply to this claim.

2 **II. BACKGROUND**

3 On September 1, 2001, PacifiCare loaned SJMC \$800,000 pursuant  
4 to a promissory note ("Note") and a loan agreement ("Loan Agreement").  
5 Section 2.5 of the Loan Agreement provided that the loan was to be  
6 forgiven on and as of December 31, 2003, if SJMC met certain  
7 conditions. Specifically, section 2.5 of the Loan Agreement provides:

8 2.5 Forgiveness of Repayment. Lender shall forgive  
9 Borrower's obligations to repay the loan if Borrower is in  
10 full and complete compliance with each of the following  
11 conditions on and as of December 31, 2003.

12 2.5.1 Borrower shall be in full and  
13 complete compliance with all covenants,  
14 conditions, and requirements contained in the IPA  
15 Services Agreement (or any successor agreement  
16 thereto), and Borrower shall not be in breach of  
17 any provisions of the IPA Services Agreement (or  
18 any successor agreement thereto).

19 2.5.2 The IPA Services Agreement shall have  
20 been renewed and in force and effect as of  
21 January 1, 2004, or the IPA Services Agreement  
22 shall have been superceded, which superceding  
23 documents shall be in force and effect as of  
24 January 1, 2004.

25 2.5.3 Borrower shall not be insolvent.  
26 Borrower shall be deemed to be insolvent when and  
27 if (i) Borrower ceases or fails to be solvent,  
28 meaning that either (a) Borrower fails to pay, or  
admits its inability to pay, its debts as they  
come due, subject to applicable grace periods, if  
any, whether at stated maturity or otherwise, or  
(b) PacifiCare reasonably determines that  
Borrower is unable to pay such debts as they  
become due, subject to applicable grace periods,  
if any, whether at stated maturity or otherwise;  
(ii) Borrower fails to maintain the financial  
reserves required by Borrower under the IPA  
Services Agreement, as amended (or any successor  
agreement thereto), if any; (iii) Borrower  
voluntarily ceases to conduct business in the  
ordinary course; (iv) Borrower commences any  
insolvency proceeding with respect to itself;  
(v) Borrower takes any action to effectuate or  
authorize an insolvency proceeding; or  
(vi) Borrower lacks the financial resources to

fulfill Borrower's obligations under either or both of the IPA Services Agreement, as amended (or any successor agreements thereto), or this Agreement. No insolvency shall be deemed to exist if such conditions are solely the result of Lender's failure to pay to Borrower amounts that are currently due and payable by Lender after consideration of Borrower's withhold, recoupment, offsets and any other rights pursuant to this Agreement, either of the IPA Services Agreement, as amended, or any other agreement between Lender and Borrower.

SJMC filed its bankruptcy petition on September 30, 2002. Neither SJMC's schedules nor its amended schedules list the Loan Agreement or Note as executory contracts. PacifiCare filed a secured proof of claim on January 28, 2003, and filed an amended claim on August 26, 2004. The amended claim asserts a nonpriority unsecured claim for \$891,915.29 of which \$843,336.99 is attributed to the Loan Agreement. SJMC's plan of reorganization was confirmed on August 31, 2004, and the effective date in the plan was September 27, 2004.

SJMC's confirmed plan classifies PacifiCare's claim as follows:

2.3.3 Class 2-B3. Class 2-B3 consists of the secured Claim of PacifiCare of California filed against SJMC and secured by rights of setoff and recoupment. Class 2-B3 is unimpaired under section 1124 of the Bankruptcy Code.

SJMC's confirmed plan treats PacifiCare's claim as follows:

4.3.3 Class 2-B3. Class 2-B3 consists of the secured Claim of PacifiCare of California filed against SJMC and secured by rights of setoff. The Reorganized Debtors will pay the holder of the secured Allowed Claim in Class 2-B3 in accordance with the terms of the agreement between such holder and the Debtors in effect at Confirmation in full satisfaction of the secured Allowed Claim.

Article X of SJMC's confirmed plan treats executory contracts and unexpired leases as follows:

All executory contracts and unexpired leases to which either or both of the Debtors are a party as of the Filing Date that are either (1) listed on Exhibit A to this Plan,

1 as such Exhibit A may be amended until Confirmation,  
2 (2) have been assumed by prior orders of the Bankruptcy  
3 Court, or (3) are assumed by either or both of the Debtors  
4 prior to the Effective Date, and which assumption has been  
approved by an order of the Bankruptcy Court prior to the  
Effective Date, shall be deemed assumed pursuant to  
Bankruptcy Code section 365(a).

5 Except for those executory contracts and unexpired  
6 leases set forth in the preceding paragraph, all other  
7 executory contracts and unexpired leases to which either or  
8 both of the Debtors are a party as of the Filing Date shall  
9 be and hereby are rejected, effective as of such Effective  
10 Date. Proofs of claim for Claims arising from the  
11 rejection of executory contracts or unexpired leases must  
12 be filed with the Bankruptcy Court and served on counsel  
13 identified on the first page of this Plan within thirty  
(30) calendar days of the Effective Date or such claims  
shall be forever barred and the holders thereof shall not  
participate in any Distributions under the Plan related to  
the rejected agreement; provided, however, the foregoing  
provision does not extend any deadline for filing proofs of  
claim arising from the rejection of executory contracts or  
unexpired leases that was established by prior Bankruptcy  
Court Order.

14 Since PacifiCare's amended claim - filed four days before the  
15 confirmation hearing on the plan - reclassified its claim from secured  
16 to unsecured, SJMC and PacifiCare agreed that PacifiCare's amended  
17 claim would be treated as an unsecured claim for voting purposes, but  
18 reserved all other rights with respect to its treatment.

19 In February 2005, Trustee objected to PacifiCare's amended proof  
20 of claim.

### 21 **III. LEGAL STANDARD**

22 Federal Rule of Civil Procedure 56(c), made applicable to  
23 contested matters through Federal Rule of Bankruptcy Procedure 9014,  
24 governs motions for summary judgment and provides "judgment sought  
25 shall be rendered forthwith if the pleadings, depositions, answers to  
26 interrogatories, and admissions on file, together with the affidavits,  
27 if any, show that there is no genuine issue as to any material fact  
28 and that the moving party is entitled to a judgment as a matter of

1 law."

2 "[The] party seeking summary judgment always bears the initial  
3 responsibility of informing the ... court of the basis for its motion,  
4 and identifying those portions of 'the pleadings, depositions, answers  
5 to interrogatories, and admissions on file, together with the  
6 affidavits, if any,' which it believes demonstrate the absence of a  
7 genuine issue of material fact." Celotex Corp. v. Catrett, 477 U.S.  
8 317, 323, 106 S.Ct. 2548 (1986), quoting Fed. R. Civ. P. 56(c).

9 If the movant meets this burden of production, the nonmoving  
10 party must go beyond the pleadings and by affidavit, deposition,  
11 answers to interrogatories, and admissions on file, designate specific  
12 facts showing that there is a genuine issue for trial. Id. at 324.

13 **IV. DISCUSSION**

14 **A. Executory Contract Issue.**

15 PacifiCare asserts that the Loan Agreement is not an executory  
16 contract under Bankruptcy Code § 365 since there is no unperformed  
17 obligation of PacifiCare. The only remaining obligation under the  
18 Loan Agreement is SJMC's obligation to repay the loan, and contracts  
19 that only require payment by the debtor are not executory. In re THC  
20 Financial Corp., 686 F.2d 799, 804 (9th Cir. 1982). The unmatured  
21 forgiveness condition did not render the Loan Agreement executory  
22 since PacifiCare was under no duty to insure that the condition was  
23 satisfied.

24 Moreover, SJMC did not include the Loan Agreement as an executory  
25 contract in either its original or its amended Schedule G. That  
26 omission is a judicial admission under In re Bohrer, 266 B.R. 200  
27 (Bankr. N.D. Cal. 2001), and precludes SJMC from taking the position  
28 that the Loan Agreement is an executory contract. SJMC also did not

1 list the Loan Agreement as an executory contract to be assumed under  
2 the plan and any contract not so assumed was deemed rejected under the  
3 terms of the plan.

4 Trustee asserts that the Loan Agreement is an executory contract  
5 because the Loan Agreement requires more than the simple repayment of  
6 money and is distinguishable from THC Financial. Sections 2.5.1 and  
7 2.5.2 of the Loan Agreement require SJMC to comply with the provisions  
8 of the IPA Services Agreement. Under the IPA Services Agreement, SJMC  
9 and PacifiCare must negotiate annual amendments. Thus, sections 5.2.1  
10 and 5.2.2 are obligations of both parties and the failure of either  
11 party to complete performance would constitute a material breach  
12 excusing performance of the other party. Further, the Loan Agreement  
13 requires SJMC to use the loan funds in a certain way and this renders  
14 the Loan Agreement executory. SJMC's failure to list the Loan  
15 Agreement on its Schedule G does not require the court to draw a legal  
16 conclusion regarding the treatment of the Loan Agreement as an  
17 executory contract.

18 Under Ninth Circuit authority, an executory contract is one where  
19 the obligations of both parties "are so far unperformed that the  
20 failure of either to complete performance would constitute a material  
21 breach excusing the performance of the other." In re Pacific Express,  
22 Inc., 780 F.2d 1482, 1487 (9th Cir. 1986), quoting Countryman,  
23 Executory Contracts in Bankruptcy: Part I, 57 Minn. L. Rev. 439, 460  
24 (1973). There is nothing in the Loan Agreement that renders it an  
25 executory contract under Pacific Express and THC Financial.  
26 PacifiCare loaned SJMC \$800,000 and SJMC agreed to repay that amount  
27 unless the loan was forgiven.

28 Sections 2.5.1, 2.5.2, and 2.5.3 of the Loan Agreement are  
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1 conditions that, if satisfied, would render the loan forgiven. Loan  
2 Agreement section 2.5.1 requires that SJMC be in full compliance with  
3 the provisions of the IPA Services Agreement before PacifiCare is  
4 obligated to forgive the Note. Loan Agreement section 2.5.2 requires  
5 that SJMC and PacifiCare have a renewed IPA Services Agreement on  
6 January 1, 2004. Loan Agreement section 2.5.3 requires that SJMC not  
7 be insolvent. There is nothing in the Loan Agreement that requires  
8 PacifiCare to renew the IPA Services Agreement as SJMC contends.  
9 Section 2.5 are three conditions that, if the conditions were met on  
10 December 31, 2003, PacifiCare would forgive the loan; if not, it would  
11 not. There is nothing executory about them.

12 Moreover, SJMC did not consider the Loan Agreement to be an  
13 executory contract either in its original and amended schedules or in  
14 the list of executory contracts to be assumed under its plan of  
15 reorganization. While Bohrer does not preclude SJMC from asserting  
16 that the Loan Agreement is an executory contract, the schedules and  
17 list of executory contracts to be assumed under the plan are contrary  
18 evidence of SJMC's current position and the court can take notice of  
19 that fact. Assuming the Loan Agreement is an executory contract, then  
20 under the express terms of Article X, the Loan Agreement was an  
21 executory contract as of the filing date and, under the plan, SJMC  
22 either assumed or rejected all executory contracts in place as of the  
23 filing date. Since the Loan Agreement was not an assumed executory  
24 contract under the plan or prior to the plan, the plan provided "all  
25 other executory contracts and unexpired leases to which either or both  
26 of the Debtors are a party as of the Filing Date shall be and hereby  
27 are rejected, effective as of such Effective Date." Joint Plan of  
28 Reorganization (August 30, 2004), Article X. Thus, if the Loan

1 Agreement were an executory contract, the confirmed plan rejected it  
2 although that is not what SJMC now contends happened.

3 **B. Applicability of Bankruptcy Code § 1124 Issue.**

4 PacifiCare asserts Bankruptcy Code § 1124 does not apply to its  
5 claim because the confirmed plan does not mention treating  
6 PacifiCare's claim under § 1124(2). Moreover, SJMC's ability to  
7 ignore the financial solvency provisions under § 1124(2)(A) only apply  
8 if PacifiCare's claim was unimpaired. PacifiCare's claim was treated  
9 as a general unsecured claim under the confirmed plan and will be paid  
10 a maximum of 75% on its claim. Thus, PacifiCare's claim was impaired  
11 under § 1124 and none of the subsections of § 1124(2) apply in this  
12 case. Further, SJMC's failure to qualify for the loan forgiveness was  
13 the failure of a condition and not an event of default, so  
14 § 1124(2)(A) is inapplicable since that section only nullifies the  
15 consequences of a default.

16 Trustee asserts that Bankruptcy Code § 1124 applies because the  
17 plan contemplated execution of an amendment such that SJMC would meet  
18 all of the conditions necessary to qualify for forgiveness under the  
19 Loan Agreement. Trustee asserts In re Entz-White Lumber and Supply,  
20 Inc., 850 F.2d 1338 (9th Cir. 1988), requires a flexible view of the  
21 defaults that can be cured under § 1124. Section 6.1 lists the events  
22 of default under the Loan Agreement and section 6.1(n) of the Loan  
23 Agreement provides:

24 Other Breach. Borrower breaches or fails to observe or  
25 perform any other term, covenant, or condition contained in  
26 this Agreement or the Note, and Borrower is unable to cure  
27 the breach or other situation within fifteen (15) calendar  
days after Lender has furnished Borrower with a written  
request to take appropriate corrective action.

28 Under this provision, the failure of the conditions set forth in



1 section 2.5 of the Loan Agreement was a default and, under Bankruptcy  
2 Code § 1124(2)(A), the financial solvency condition is not required  
3 to be met.

4 Bankruptcy Code § 1124 provides:

5 Except as provided in section 1123(a)(4) of this title, a  
6 class of claims or interests is impaired under a plan  
7 unless, with respect to each claim or interest of such  
8 class, the plan -

9 (1) leaves unaltered the legal, equitable, and  
10 contractual rights to which such claim or  
11 interest entitles the holder of such claim or  
12 interest; or

13 (2) notwithstanding any contractual provision or  
14 applicable law that entitles the holder of such  
15 claim or interest to demand or receive  
16 accelerated payment of such claim or interest  
17 after the occurrence of a default -

18 (A) cures any such default that  
19 occurred before or after the  
20 commencement of the case under this  
21 title, other than a default of a kind  
22 specified in section 365(b)(2) of this  
23 title;

24 (B) reinstates the maturity of such  
25 claim or interest as such maturity  
26 existed before such default;

27 (C) compensates the holder of such  
28 claim or interest for any damages  
incurred as a result of any reasonable  
reliance by such holder on such  
contractual provision or such  
applicable law; and

(D) does not otherwise alter the  
legal, equitable, or contractual  
rights to which such claim or interest  
entitles the holder of such claim or  
interest.

Bankruptcy Code § 365(b)(2) provides:

(2) Paragraph (1) of this subsection does not apply to a  
default that is a breach of a provision relating to -

(A) the insolvency or financial condition of the  
debtor at any time before the closing of the

1 case;

2 (B) the commencement of a case under this title;

3 (C) the appointment of or taking possession by a  
4 trustee in a case under this title or a custodian  
before such commencement; or

5 (D) the satisfaction of any penalty rate or  
6 provision relating to a default arising from any  
7 failure by the debtor to perform nonmonetary  
obligations under the executory contract or  
unexpired lease.

8 Trustee's argument is not persuasive for two reasons. First,  
9 while Entz-White Lumber reads Bankruptcy Code § 1124(2) to permit cure  
10 of any default and not just a default that accelerates a debt, the  
11 failure of SJMC to meet the three criteria to ensure forgiveness of  
12 the loan is not a default under the Loan Agreement. Trustee's  
13 argument that section 6.1(n) of the Loan Agreement that provides for  
14 an event of default if SJMC "breaches or fails to observe or perform  
15 any other term, covenant, or condition contained in this Agreement"  
16 and SJMC's failure to meet the conditions of forgiveness of repayment  
17 is such a default is a tortured reading of the Loan Agreement.  
18 Section 2.5 of the Loan Agreement is an agreement between the parties  
19 that, if certain conditions are met at a certain time, the Loan  
20 Agreement would be treated in a certain way, i.e., be forgiven. If  
21 those conditions were not met as of that time, then the Note would  
22 remain in place. Section 2.5 does not provide for a default if those  
23 conditions were not met. Article 3 of the Loan Agreement provides for  
24 nine conditions precedent to the making of the loan. Clearly the  
25 parties knew how to draft the contract to provide for one party's  
26 excuse to perform if certain conditions were not met, and that is not  
27 the case with section 2.5.

28 Second, the treatment of Class 2-B3 in SJMC's confirmed plan does  
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1 not indicate clearly that SJMC seeks to hold the claim as unimpaired  
2 under § 1124(2) and section 2.5.3 of the Loan Agreement unenforceable  
3 pursuant to § 1124(2)(A). The treatment of the claim states that:  
4 "Class 2-B3 is unimpaired under section 1124 of the Bankruptcy Code."  
5 Bankruptcy Code § 1124(1) provides that a claim is unimpaired based  
6 on "the legal, equitable, and contractual rights to which such claim  
7 or interest entitles the holder of such claim or interest" remaining  
8 unaltered. SJMC created the confusion over which subsection of  
9 Bankruptcy Code § 1124 it intended in its plan, and any ambiguity  
10 should be construed against SJMC as the drafter of the plan. In re  
11 Miller, 363 F.3d 999, 1005-06 (9th Cir. 2004). Moreover, confirmation  
12 of the plan took place after the date upon which forgiveness of the  
13 loan repayment was determined. Thus, if SJMC assumed that the  
14 repayment forgiveness provision was enforceable and the loan forgiven,  
15 SJMC should have stated that clearly in its plan and alerted  
16 PacifiCare to that interpretation.

17 **V. CONCLUSION**

18 The court finds that the Loan Agreement is not an executory  
19 contract and Bankruptcy Code § 1124 does not eliminate the application  
20 of section 2.5.3 of the Loan Agreement. This matter needs to be set  
21 for an evidentiary hearing as to whether, as of December 31, 2003,  
22 SJMC complied with the conditions of section 2.5 of the Loan  
23 Agreement. A telephonic status conference on this objection to claim  
24 shall be held on April 13, 2005 at 10:30 a.m.

25  
26 DATED: \_\_\_\_\_

27  
28 \_\_\_\_\_  
JAMES R. GRUBE  
UNITED STATES BANKRUPTCY JUDGE

Case No. 02-55472-JRG  
01-55473-JRG

UNITED STATES BANKRUPTCY COURT  
FOR THE NORTHERN DISTRICT OF CALIFORNIA

CERTIFICATE OF SERVICE

I, the undersigned, a regularly appointed and qualified Judicial Assistant in the office of the Bankruptcy Judges of the United States Bankruptcy Court for the Northern District of California, San Jose, California hereby certify:

That I, in the performance of my duties as such Judicial Assistant, served a copy of the Court's: **ORDER ON CROSS SUMMARY JUDGMENT MOTIONS REGARDING THE OBJECTION TO THE CLAIM OF PACIFICARE** by placing it in the United States Mail, First Class, postage prepaid, at San Jose, California on the date shown below, in a sealed envelope addressed as listed below.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on \_\_\_\_\_ at San Jose, California.

\_\_\_\_\_  
LISA OLSEN

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